السعودي الفرنسي كابيتال
Saudi Fransi Capital

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2019 KSA MARKET OUTLOOK

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Executive Summary

Market performance during 2018 can be attributed to foreign inflows in the first half and outflows in the second. Active management paid-off early in the year while buy-and-hold was prudent in the latter months. In this note, we take clues from investor mindset, economic undercurrents and potential extraordinary events to determine market direction for the upcoming year. Once again, we see varying performance in first half from second half although this time due to reversal in underpinning factors.

Market earnings (+1% Y/Y through 9M18) were primarily driven by banks and petrochemicals. Rising rates improved net interest margins and cushioned against tepid loan growth for banks. While petrochemicals benefited from commodity price improvement. Elsewhere, nearly two out of three companies reported lower earnings growth despite coming off a weak year.

During last December we introduced our top picks for the year. In hindsight, timing the exit was critical. For example, BUDGET AB and CARE AB reached highs of +63% and +59% since our report. However, investor mindset was focused on downside risk (fear) and gravitated towards large caps with strong bias for banks and petrochemicals. Despite attractive valuations, mid- and small-cap names were overlooked on heightened sensitivity to earnings miss.

For 2019 market is pinning hopes on the expected 2.3% GDP growth to spur investment and capital flow. So far this year, while fiscal numbers look encouraging, transmission to ground effect is missing. We believe the planned SAR 1.1 tn expenditure for next year will remain intact despite short-term oil price volatility, however deficit is unlikely to slip beyond 5.5% of GDP. Economic stimulus and job creation will remain front-and-center.

In setting our market outlook for next year, our core assumptions include: oil averaging $60 to $65, no major subsidy adjustment (fuel, electricity), unaltered fee trajectory (foreign workers) and MSCI EM implementation on track. The most seismic assumption is an acceleration in Saudization through 2019/20 to achieve unemployment targets. Potentially the scope could increase to other sectors and roles. Near-term market impact will be negative however more women in the workforce could generate previously under-tapped consumer base. Key risk will be downsizing in overall job market as businesses exit which could create ripple effects on other sectors (for example commercial space vacancies).

We apply a target P/E multiple of 17.5x to gauge fair value however caution that consensus earnings expectations appear aggressively optimistic (+20% for 2018 and +10% for 2019). In contrast, we see earnings rising +2.5% in both 2018 and 2019. We ascribe fair level for the market at 8,138. For 1H19, earnings are expected to be lower but target P/E higher yielding 8,119 level (index implementation). While for 2H, earnings will be higher but target P/E lower (post-implementation profit taking) yielding 7,663 level.

Our outlook does not preclude the possibility of outliers which could drive market higher to 8,872 and lower to 6,775. Some events triggering extreme reaction include rapid decline in oil price beyond psychologically important threshold, sell-off in emerging markets and easing in geopolitical situation.

Stemming from Vision Realization Programs (VRP), we derive 10 investment themes which could gain traction during the year. While Government Capital Spending is the most economically pervasive theme – sectors least exposed include: insurance and petrochemicals.

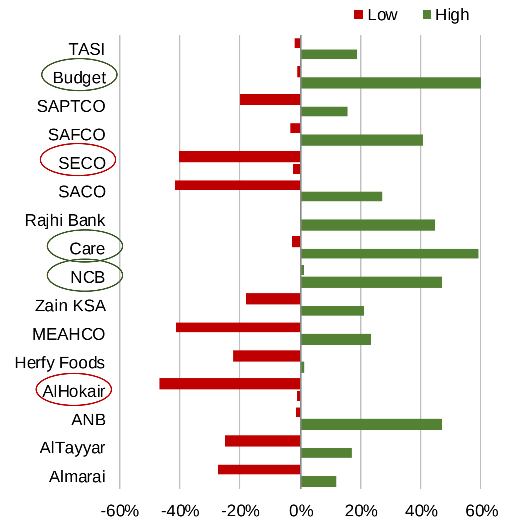
INVESTMENT THEMES
Travel, Tourism & Entertainment
Job Creation
Home Ownership
Exports
Govt Capital Spending
Govt Special Allowances
Local Content
Regulatory Reform
Consolidation
Privatization

2019 TASI EXPECTATION	
Full year	8,138
1H	8,119
2H	7,663
High	8,872
Low	6,775

Investor Mindset

Looking back at 2018, buy-and-hold strategy across Banks and Petrochemicals was prudent as rising rates and oil prices propelled earnings higher. However, stock selection, particularly during 1H18 paid-off with timing being critical – knowing when to enter and exit. The Saudi market (TASI) gained up to +19% and lost as much as -2% since our Outlook 2018 report. Meanwhile our Top Picks had a much broader high-low range (see Fig. 1). Notably, BUDGET AB had a H-L range of +63% to -1% followed by CARE AB with +59% to -3%. SECO AB and ALHOKAIR AB showed disappointing performance, ranging -2% to -40% and -1% to -47%, respectively.

FIG 1: TOP PICKS H-L THROUGH 2018



Source: Tadawul

Tight spending control through 9M18

Overlaying macro, market and corporate performance may shed some light on investor behavior during the year. From a fiscal standpoint, we expected state revenue diversification to gain traction during the year on 5% VAT introduction, fees on foreign workers and subsidy adjustment. Ministry of Finance figures indicate +48% Y/Y growth in non-oil revenues through 9M18 to SAR 211 bn, comprising some 32% of total (see Table 1). In addition, oil revenues jumped +47% Y/Y to SAR 452 bn thanks to resurgent Brent, averaging $70 per barrel YTD (+40% Y/Y). Meanwhile spending has been under control, as the country appears comfortably below its SAR 148 bn deficit target (5% of GDP). Fiscal position is encouraging the government to boost spending (some SAR 67 bn in new projects announced recently), in addition to +7% expansionary budget for 2019. With this backdrop, ordinarily the market should have reacted jubilantly.

TABLE 1: FISCAL SNAPSHOT

SAR bn	1Q18	2Q18	3Q18	YTD
Revenues	166	273	223	663
Oil	*114*	*184*	*154*	*452*
Non-oil	*52*	*89*	*69*	*211*
Expenditure	201	281	231	712
Surplus / deficit	-34	-7	-7	-49

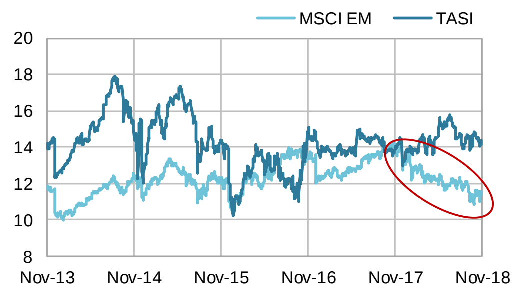
Y/Y Change	1Q18	2Q18	3Q18	YTD
Revenues	15%	67%	57%	47%
Oil	*2%*	*82%*	*63%*	*47%*
Non-oil	*63%*	*42%*	*45%*	*48%*
Expenditure	18%	34%	21%	25%

Source: MoF, SFC

The much anticipated inclusion into MSCI Emerging Markets was announced in June 2018, with implementation taking place from mid-2019. Normally, the upgrade drives stock market rallies between inclusion and implementation phases on expected passive inflows - ranging $8 to $10 bn in the case of Saudi market. During 1H18, net foreign flows reached nearly SAR 14 bn but dramatically reversed trend in 2H18. In the trailing 8 weeks alone, foreign investors have sold some SAR 8 bn in Saudi equities. Lukewarm demand from foreign and retail investors was offset by domestic institutional buyers. The selling frenzy may have lowered risk appetite for mid- and small-cap names. On the flip side, emerging markets faced challenges of their own, particularly those with large dollar denominated debt. Weakening currencies against USD accelerated outflow from EM.

Lower investor appetite for small- and mid-cap names

FIG 2: FORWARD P/E RATIO

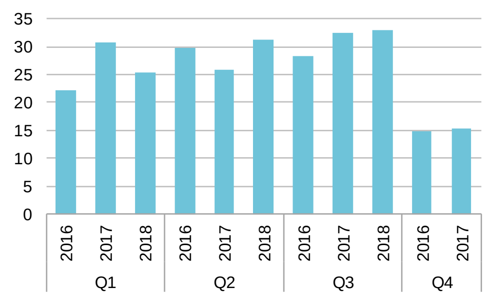


Source: Bloomberg

In our view, the single biggest factor affecting investor behavior was earnings expectation. Through 9M18, market earnings gained +1% Y/Y but dramatically decelerated in 3Q versus 2Q growth. Margins are under pressure with limited pricing power. Although consumer caution has eased from 2016 levels, the shrinking consumer base is straining topline growth, directing focus to market share gain. Contending with these challenges, businesses have to cope with rising costs, particularly personnel – latest labor figures suggest +6% annualized wage inflation rate. Our investment case for 2018 raised the prospect of increased merger activity - benefiting from scale and market share gain. So far, few merger announcements have surfaced in Banks, Petrochemicals and Food.

Aversion to earnings miss and consequent sell-off

FIG 3: TASI EARNINGS (SAR BN)



Source: Tadawul

In summary, our investor behavioral observations suggest growing market maturity. Inclusion into emerging markets index is raising comparability awareness as well as investor composition (higher institutionalized ownership). While initial reaction on occasion has been severe, investors come back to quality names on valuation appeal. Recent slide in oil price would have triggered market sell-off in the past (for example 2016), however this time around, market participants feel more confident in policy response.

Economic Outlook

Saudi Arabia took the extraordinary step of pre-announcing the 2019 budget (headline figures) this year. Details are expected in the second half of December along with the comprehensive budget announcement. Headline figures indicate +7.4% expansionary budget at SAR 1.1 tn. Deficit is expected to moderate to -4.1% of GDP and will be plugged by debt primarily. Economic growth is projected to pick-up from +2.1% to +2.3%. Conversely, the IMF is projecting slower growth next year for US and China at +2.5% and +6.2%, respectively. Consensus view points to roughly 10% drop in Brent, stronger USD and 90 basis point increase in US target rate next year. Rather than explicit oil forecast, we attempt to anticipate policy response at varying oil price and export scenarios. The government has room to modulate expenditure subject to fiscal discipline targets and economic stimulus objectives.

Deficit to be plugged by debt primarily

TABLE 2: BUDGET AND MACRO OUTLOOK

SAR bn	2018E	2019P	2020P	2021P
Revenues	882	978	1,005	1,045
Expenditure	1,030	1,106	1,143	1,170
Surplus / (deficit)	(148)	(128)	(138)	(125)
Nominal GDP	2,934	3,136	3,232	3,387
Deficit-to-GDP	*-5.0%*	*-4.1%*	*-4.3%*	*-3.7%*
Debt	576	678	754	848
Debt-to-GDP	*20%*	*22%*	*23%*	*25%*
Real GDP growth	*2.1%*	*2.3%*	*2.2%*	*2.4%*
Inflation	*2.8%*	*2.3%*	*2.1%*	*2.1%*

Source: MoF

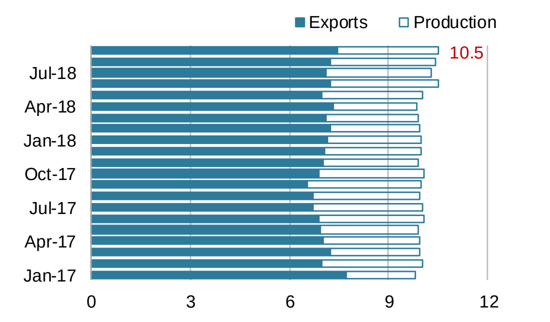
Budget Concerns

The recent slide in oil price has once again triggered discussion on KSA budgetary impact despite strong gain in non-oil revenue this year. Namely, will appetite for deficit and debt remain intact if oil demand remains subdued for several years? Will efforts to diversify revenue base accelerate? Will spending curtail to 2016 levels? What does it mean for job growth?

Spending to remain intact to boost business confidence and job creation

In our view, spending will likely remain elevated through 2020 (i.e. north of SAR 1 tn) irrespective of oil price volatility. We believe the government will remain committed to boosting economic growth to kick start business spending and job creation. As the improvement takes hold, private sector will be better positioned to take on greater share of economic boost. At the same time, we believe there will be strict deficit tolerance level – meaning that spending at all cost will not be the case.

FIG 4: KSA OIL PRODUCTION AND EXPORTS (MN BARRELS)



Source: JODI

While efforts to diversify revenue base have yielded positive results, we believe a fine balance also needs to be struck to ease economic transition. New fees or taxes are

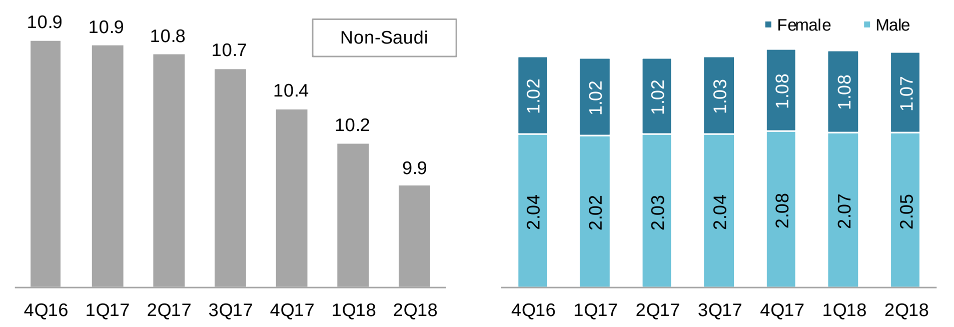
not expected to roll-out over the next two years. In addition, further subsidy adjustment may be scrutinized to alleviate private sector headwinds. While non-oil revenue growth will decelerate going forward, we continue to see it comprising a significant chunk of overall state revenues (c. 30%).

Coordinated oil policy and lessons learned lower risk of hard brakes

Since beginning of October, Brent has declined c. -30%, reminiscent of 2015/16 slide, triggering tight spending control. Last time around capital expenditure was cut and payments were slowed. Now, we believe coordinated oil policy (OPEC+) and past lessons learned have lowered the possibility of hard brakes on spending. Arrears are getting paid with regularity and should continue through next year. Spending efficiency has rationalized project backlog but maintained overall spending level above SAR 1 tn in 2018. Key in our view will be project visibility, tangibility and economic impact. Despite stark contrast in GDP numbers between 2017 and 2018E, has ground reality significantly altered? Required will be noticeable change in business activity, job creation and loan demand but more broadly business sentiment and capital deployment.

Labor figures show 12.9% unemployment rate despite measures to nationalize various sectors. One option could be to expand public sector payroll at the expense of capital expenditure. Second option could be to accelerate nationalization drive across other sectors (for example healthcare or education). And third option could be to boost economic growth and expand the overall job market. We see a combination of option 2 and 3 moving forward.

FIG 5: WORKFORCE COMPOSITION (MN)



Source: GA Stat

Deficit unlikely to stretch beyond 5.5% of GDP next year

In summary, we believe growth will remain top-of-mind action item despite short-term oil volatility. However, persistent low price (sub-$60) and widening deficit could slow spending. We see limited appetite to stretch deficit beyond -5.5% of GDP. Conversely, $8 improvement in price (Brent currently c. $62) could create headroom to modestly raise spending from the planned SAR 1.1 tn for 2019.

TABLE 3: 2019 FISCAL DEFICIT-TO-GDP SENSITIVITY

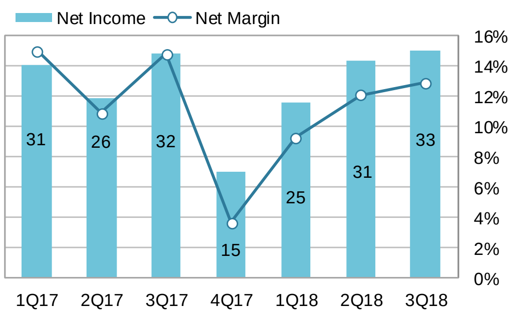
		Realized Oil Price					
		$50	$55	$60	$65	$70	$75
Exports (mbpd)	7.2	-10.1%	-8.6%	-7.0%	-5.4%	-3.9%	-2.3%
	7.3	-9.9%	-8.3%	-6.7%	-5.2%	-3.6%	-2.0%
	7.4	-9.7%	-8.1%	-6.5%	-4.9%	-3.3%	-1.6%
	7.5	-9.5%	-7.9%	-6.2%	-4.6%	-2.9%	-1.3%
	7.6	-9.3%	-7.6%	-6.0%	-4.3%	-2.6%	-1.0%

Source: SFC

Market Outlook

So far this year market earnings and net margin have steadily increased largely due to rising rates and commodity prices supporting banks and petrochemicals (see Fig 6). Excluding these two pockets of strength, nearly 2 out of 3 companies have reported lower net income. Sectors levered to infrastructure and consumer spending fared poorly during the year.

FIG 6: TASI EARNING (SAR BN) AND NET MARGIN



Source: TASI

Extraordinary Events

Extraordinary events (unknowns) occur with regularity and low predictability. These events could emanate domestically or internationally creating broader market impact. We outline some potential known extraordinary events that could set market direction in the year ahead.

Base case:
$60 - $65

Oil price – our base case sees Brent moving higher during 1H19 and moderating in the second half to average between $60 to $65 for full year. This means government spending should remain on track and primary market earners (banks and petrochemicals) should announce flat bottom lines. If however, oil slides towards $50, we expect to see pullback in spending (deferred payments) and heightened business caution.

Base case:
No fuel or electricity increase in 2019

Subsidy adjustment – the Fiscal Balance Program targets to raise kerosene and LPG for retail sector to benchmark prices in 2019. Diesel and gasoline are expected to edge higher over a 7-year time horizon which means the increments could be modest if not zero in 2019. Users of natural gas will have relief in 2019 but could see increases in the following year. Our operating assumption is that fuel and utilities will not increase next year, allowing businesses and consumers to adjust to the previously implemented increments. If higher fuel prices are announced, initial market reaction may be negative.

Base case:
New fees unlikely

Fees – even in the scenario of rapid oil price decline, we see the introduction of new fees as an unlikely event. Consumer and business confidence remains fragile and could be further damaged by surprise fee announcement. By next year, businesses will have adjusted to foreign worker fees by rationalizing headcount and value-added tax (VAT). Wage inflation (expected at 6%) coupled with fee step-up will pressure personnel costs.

Base case:
Additional roles could be nationalized

Saudization – following Saudization in Retail between September and January, we see program expansion to other areas in 2019/20. Hard to predict future targets but we believe food/restaurant may be an area of interest. Additionally, minimum quotas across wide range of businesses may be raised (for example hospitality). Forced measures have yielded mixed results – job creation in some areas and permanent losses in other. No readily available hard evidence has surfaced to support either

side of the argument. Nonetheless, market reaction will be negative towards affected sectors as the wage differential remains 2-3x.

Base case: EM index implementation in mid-2019

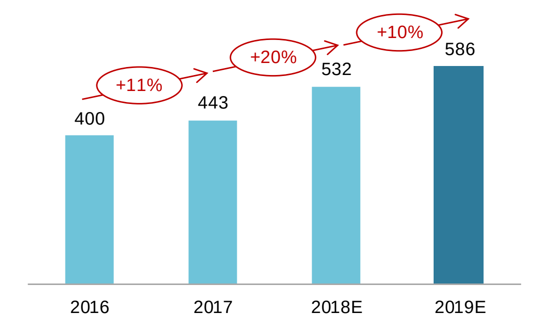
MSCI EM implementation – Saudi market was included in MSCI EM index last June and implementation will take effect from mid-2019. Funds tracking the index are expected to generate up to $10 bn in passive flows over subsequent months. The market is expected to rally in the run-up to the implementation and likely cool-off post-event. This suggests that valuation multiples will reach abnormal levels and normalize during back half of the year.

Market Target Level

We apply a target P/E multiple to determine TASI fair value. Ordinarily, forward P/E is appropriate (on 2020E EPS) however given the unrealistic consensus earnings expectations, we believe trailing multiple is more relevant. For example, Fig 7 shows that consensus pegs TASI earnings growth at +20% Y/Y for 2018 whereas through 9M of the year, earnings are up only +1%. Therefore the SAR 532 number appears out of reach. Further, 2019 EPS of SAR 586 (+10% Y/Y) seems equally unrealistic, in our view.

Unrealistic earnings growth expectation

FIG 7: TASI EPS (SAR)



Source: Bloomberg

The market is currently trading 17.1x trailing P/E versus 12.2x for MSCI EM. Over the last 12 months, the premium to EM has widened. In our view, if outflows from EM accelerate over the coming months (trade tensions, currency, rates), the multiple de-rating for Saudi could be severe following implementation. Consequently, we see varying performance during the two halves.

Expect varying market performance during each half

TABLE 4: TASI VALUATION SENSITIVITY

2019E EPS →	-6% 437	-3% 451	0% 465	3% 479	6% 493
Target P/E Multiple 15.5x	6,775	6,991	7,208	7,424	7,640
16.0x	6,994	7,217	7,440	7,663	7,886
16.5x	7,212	7,442	7,673	7,903	8,133
17.0x	7,431	7,668	7,905	8,142	8,379
17.5x	7,649	7,893	8,138	8,382	8,626
18.0x	7,868	8,119	8,370	8,621	8,872

Source: SFC

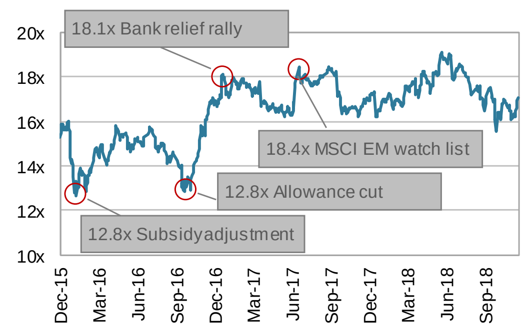
Our base case sees 2018E EPS growth at +2.5% to SAR 454 followed by another +2.5% for 2019 reaching SAR 465. During 1H19, we expect earnings to be weaker by c. -3% Y/Y but the target P/E higher at 18.0x yielding a fair value of 8,119. However, in 2H19, we estimate earnings improvement but weaker P/E multiple of 16.0x yielding 7,663 level. For the full-year we expect market P/E at 17.5x yielding

8,138 target level. Note that investor reaction could swing in either direction given the extraordinary events outlined above, from severe pessimism to unwarranted optimism.

Peak and Trough

Our valuation sensitivity (see Table 4 above) portrays a market high of 8,872 and low of 6,775 for next year. Under what circumstances will these extremes materialize?

FIG 8: TASI P/E EXTREMES SINCE DEC 2015

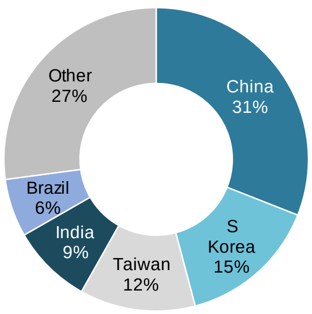


Source: Bloomberg, SFC

Lower foreign inflows could limit market re-rating

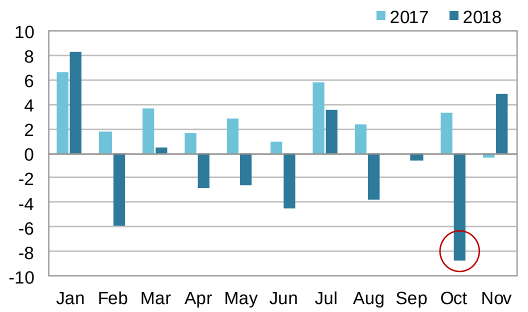
Emerging Markets – passive flow estimates for the Saudi market hinge on the overall size of assets tracking MSCI EM index ($1.8 tn) and country weighting (c. 2.5% for KSA). In the event of broad-based retreat from emerging markets, expected Saudi inflow will reduce – re-rating potential will also moderate. For instance, in October iShares EM ETF assets contracted nearly -9% as interest rate expectations pressured markets lower. Conversely, reclassification of other countries could raise Saudi weight and increase inflow.

FIG 9: MSCI EM COUNTRY WEIGHTS



Source: MSCI

FIG 10: ISHARES EMERGING MARKETS TOTAL ASSET CHANGE (%)



Source: Bloomberg

TASI VS EM KEY METRICS

	TASI	MSCI EM
P/E	17.1x	12.2x
EV/EBITDA	11.3x	7.8x
Dividend Yield	3.5%	2.9%
ROE	13%	10%
Debt-to-Equity	0.5x	1.0x
EBITDA Margin	35%	21%
Net Margin	17%	10%
2019E Revenue Growth	5%	7%
2019E Earnings Growth	10%	8%
YTD Return	9%	-13%

Source: Bloomberg

Oil – over the past year, oil and equity market correlation has weakened. We see oil providing limited P/E expansion catalyst going forward however the de-rating risk will remain high. When oil slides below psychologically important levels, Saudi market correlation rises. The lower the oil price, the higher the sensitivity (see 1Q16).

Geopolitical situation – escalating or easing political situation both global and regional could impact investor sentiment. One example could be resolution to Yemen crisis and shift towards reconstruction. Expectation of Saudi companies benefiting from infrastructure contracts could drive market higher.

Thematic Investing

Economic transformation developed around a dozen Vision Realization Programs (VRP) has created thematic investing potential. We see 10 themes taking shape over the next two years. In the following section, we assign number of companies that could potentially benefit from each theme and the associated earnings at stake. While investors anticipated Vision 2030 to deliver quick wins, it appears so far the effort largely focused on setting building blocks. We believe from 2019 onwards, progress will be tangible and potentially reflected in earnings and market performance.

TABLE 5: THEMES

Theme	Num of Companies	Earnings Exposure (SAR bn)
Travel, Tourism & Entertainment	17	1,445
Job Creation	37	57,391
Home Ownership	46	57,968
Exports	23	28,449
Govt Capital Spending	73	56,742
Govt Special Allowances	23	12,379
Local Content	31	2,903
Regulatory Reform	54	12,272
Consolidation	67	5,931
Privatization	8	8,065

Source: SFC

Travel, Tourism & Entertainment – progress has been rapid and visible on this theme with rising pilgrim numbers, live events (sporting, music) and entertainment venues. Visa regulations are easing to boost attendance and elevate KSA as a tourist destination. Entertainment megacity (outside Riyadh) is expected to move ahead with development. We believe hospitality, dining and entertainment-related names should benefit from this theme.

Travel, Tourism & Entertainment

TASI Code	Company / Sector
4090	Taiba
4100	Makkah Construction
4250	Jabal Omar
4320	Alandalus Property
4332	Jadwa Haramain REIT
4050	SASCO
1810	AlTayyar
1820	Abdulmohsen AlHokair
4010	Dur Hospitality
4170	Tourism Enterprise Co
6002	Herfy Foods
2130	Saudi Industrial Dev Co
2340	Alabdulatif Industrial Inv Co
4031	Saudi Ground Services
4260	Budget Saudi
6004	Saudi Airlines Catering
4200	Aldrees

Job Creation – we believe efforts to boost job creation for nationals will accelerate in 2019/20. In turn, higher employment will mean more consumer spending and demand for goods and services. If the efforts largely hinge on sector-by-sector Saudization, then the short-term impact will be negative with overall contraction in workforce. At the same time, higher women employment could create a new consumer class that was perhaps absent in the past.

Job Creation

TASI Code	Company / Sector
-	Banks
-	Telecoms
4130	Al-Baha Investment & Dev Co
4020	Saudi Real Estate Co
4320	Alandalus Property
4330	Riyad REIT
4333	Taleem REIT
4003	Extra
4008	SACO
4190	Jarir Marketing
4240	Fawaz AlHokair
-	Consumer Services
4011	Lazurde
4180	Fitaihi Group
2190	Saudi Industrial Services Co
6004	Saudi Airlines Catering
1201	Takween Advanced Industries
3007	Zahrat Al Waha

Home Ownership – new affordable supply and financing products are raising home ownership. We believe this should continue to benefit lenders as mortgage market further deepens. In addition, furnishing, appliances and renovation-related names should benefit.

Home Ownership

TASI Code	Company / Sector
-	Banks
-	Telecoms
4020	Saudi Real Estate Co
4150	Arriyadh Dev Co
4220	Emaar Economic City
4250	Jabal Omar
4300	Dar Alarkan
2050	Savola Group
4001	Al Othaim Markets
4006	Farm Supermarkets
1214	Shaker
4003	Extra
4008	SACO
1213	AlSorayai Group
2130	Saudi Industrial Dev Co
2340	Alabdulatif Industrial Inv Co
4180	Fitaihi Group
2040	Saudi Ceramic
2360	Saudi Vitrified Clay Pipe
-	Cements

Exports – hedged against potential domestic headwinds and leveraged to global economic environment, export-focused names mainly include petrochemicals. This theme played well in 2018. Risk of feedstock increase appears low during 2019.

Exports

TASI Code	Company / Sector
1202	Middle East Paper Co
1210	Basic Chemical Industries
1211	Ma'aden
-	Petrochemicals
2170	Alujain Corp
2180	Filing & Packaging Materials
2240	Zamil Industrial
2300	Saudi Paper Manufacturing
4140	Saudi Industrial Export Co
2190	Saudi Industrial Services Co
4230	Red Sea
4280	Kingdom Holding

Government Capital Spending – recent years have highlighted economic dependence on government spending. Pull-back or ramp-up in spending has broad impact therefore it might be more appropriate to see which sectors are not critically dependent: insurance, food, retail, petrochemicals. We are expecting capital expenditure to rise in 2019 as work on newly announced projects picks-up (northern regions, NEOM, Wedyan, Entertainment City).

Government Capital Spending

TASI Code	Company / Sector
-	Banks
-	Telecoms
2120	Saudi Advanced Industries
4080	Aseer Trading
4130	Al-Baha Investment & Dev Co
4020	Saudi Real Estate Co
4150	Arriyadh Development Co
4220	Emaar Economic City
4230	Red Sea
4310	Knowledge Economic City
-	REITs
1214	Shaker
4070	Tihama Advertising
4010	Dur Hospitality
1213	AlSorayai Group
-	Capital Goods
1301	Aslak
1304	Al Yamamah Steel
1320	Saudi Steel Pipe
2090	National Gypsum
2150	Zoujaj
2180	Filing & Packaging Materials
2200	Arabian Pipes
2220	Maadaniyah
2240	Zamil Industrial
-	Cements

Government Special Allowances – low probability event but does seem to occur on occasion. Cost-of-living allowance and Citizens' Account rolled-out this year to counter VAT and utility impact. Interesting to watch if these allowances are modified in 2019. Historically, special allowances have buoyed discretionary names however now the intent is to offset impact to consumer pockets. As a result, we see essentials benefiting more from allowances (utilities, food, fuel).

Government Special Allowances

TASI Code	Company / Sector
-	Utilities
-	Food & Agriculture
-	Food Retail
4050	SASCO
1201	Takween Advanced Industries
2030	Saudi Arabia Refineries
2380	Petro Rabigh
4200	Aldrees

Local Content – enhancing local content is one of the objectives of Vision 2030. Increasingly companies are procuring locally produced equipment. We believe the trend will gain momentum in the coming years.

Local Content

TASI Code	Company / Sector
2120	Saudi Advanced Industries
2070	Saudi Pharmaceutical
2230	Saudi Chemical Co
1302	Bawan Co
1303	Electrical Industries Co
2160	Amiantit
2320	Al-Babtain Power
1201	Takween Advanced Industries
1202	Middle East Paper Co
1210	Basic Chemical Industries
1301	Aslak
1304	Al Yamamah Steel
1320	Saudi Steel Pipe
2220	Maadaniyah
2240	Zamil Industrial
2300	Saudi Paper Manufacturing
-	Cements
3007	Zahrat Al Waha

Regulatory Reform – pace of regulatory reform has accelerated and widened. For some sectors the changes may catalyze share performance (for example expansion of private insurance coverage). Other reforms include pricing / tariff adjustment, Saudization requirements and general operating conditions (for example car rental within city limits and fuel stations on highways).

Regulatory Reform

TASI Code	Company / Sector
5110	Saudi Electricity
4320	Alandalus Property Co
-	Insurance
-	Healthcare
2050	Savola Group
2270	Sadafco
4001	Al Othaim Markets
4006	Farm Superstores
4003	Extra
4008	SACO
4050	SASCO
4240	Fawaz AlHokair
6002	Herfy Foods
4040	SAPTCO
4260	Budget Saudi
1202	Middle East Paper Co
2300	Saudi Paper Manufacturing
4200	Aldrees

Consolidation – shifting operating environment may prove unmanageable for inefficient businesses leading to market exit. Alternatively, scale (through M&A) could drive market share gains. While we expected M&A activity to pick up in 2018, it has been fairly subdued although management appetite seems elevated. Some sectors that could benefit from consolidation include insurance and cements, however progress has been slow to materialize. Saudization in retail sector is expected to push market exit, accruing benefit to larger retailers.

Consolidation

TASI Code	Company / Sector
-	Insurance
-	Healthcare
-	Food & Agriculture
4008	SACO
4050	SASCO
4240	Fawaz AlHokair
4110	Batic
2210	Nama Chemicals
2260	Sahara Petrochem
2310	Sipchem
-	Cements
4200	Aldrees

Privatization – host of state assets are in the pipeline for privatization (including schools, hospitals, airports). In turn this should bring more foreign investment in the country potentially benefiting other sectors. An area where foreign investment seems keen is entertainment which could drive investment in related infrastructure (hotels, restaurants).

Privatization

TASI Code	Company / Sector
5110	Saudi Electricity
-	Healthcare
4010	Dur Hospitality
1213	AlSorayai Group

Rating Framework

BUY
Shares of company under coverage in this report are expected to outperform relative to the sector or the broader market.

HOLD
Shares of company under coverage in this report are expected to perform inline with the sector or the broader market.

SELL
Shares of company under coverage in this report are expected to underperform relative to the sector or the broader market.

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